NEVADA LEGISLATURE
LEGISLATIVE COMMISSION'S SUBCOMMITTEE TO STUDY MORTGAGE LENDING AND HOUSING ISSUES

(*Nevada Revised Statutes* 218.682)

SUMMARY MINUTES AND ACTION REPORT

The second meeting of the Nevada Legislative Commission's Subcommittee to Study Mortgage Lending and Housing Issues was held on December 3, 2007, at 9 a.m. in Room 4401 of the Grant Sawyer State Office Building, 555 East Washington Avenue, Las Vegas, Nevada. The meeting was videoconferenced to Room 2134 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. A copy of this set of "Summary Minutes and Action Report," including the "Meeting Notice and Agenda" (**Exhibit A**) and other substantive exhibits, is available on the Nevada Legislature's website at www.leg.state.nv.us/74th/Interim. In addition, copies of the audio record may be purchased through the Legislative Counsel Bureau's Publications Office (e-mail: publications@lcb.state.nv.us; telephone: 775/684-6835).

COMMITTEE MEMBERS PRESENT IN LAS VEGAS:

Assemblyman Marcus L. Conklin, Chairman
Senator Warren B. Hardy II
Senator Michael A. Schneider
Assemblywoman Marilyn Kirkpatrick

COMMITTEE MEMBER PRESENT IN CARSON CITY:

Assemblyman Tom Grady

COMMITTEE MEMBER ABSENT:

Senator Bob Beers

LEGISLATIVE COUNSEL BUREAU STAFF PRESENT:

David Ziegler, Principal Research Analyst, Research Division
Kelly S. Gregory, Senior Research Analyst, Research Division
Daniel Yu, Deputy Legislative Counsel, Legal Division
Lucinda Benjamin, Senior Research Secretary, Research Division

OPENING REMARKS

- Assemblyman Marcus L. Conklin, Chairman, welcomed members, presenters, and the public to the second meeting of the 2007-2008 Interim.

APPROVAL OF THE "SUMMARY MINUTES AND ACTION REPORT" OF THE MEETING HELD ON OCTOBER 22, 2007, IN LAS VEGAS

- The Subcommittee **APPROVED THE FOLLOWING ACTION**:

  ASSEMBLYWOMAN KIRKPATRICK MOVED TO APPROVE THE MINUTES OF THE OCTOBER 22, 2007, MEETING IN LAS VEGAS, NEVADA. THE MOTION WAS SECONDED BY SENATOR HARDY, WHICH PASSED UNANIMOUSLY.

REVIEW OF EXTENT OF MORTGAGE LENDING PROBLEMS AND IMPACTS IN NEVADA

- Douglas G. Duncan, Ph.D., Chief Economist, Mortgage Bankers Association (MBA), Washington, D.C., presented information on the mortgage lending industry. He provided information on the National Delinquency Survey, which covers approximately 87 percent of all outstanding residential first-mortgage loans.

  Mr. Duncan compared various data from the second quarter of 2006 to the second quarter of 2007. For the United States, total loans past due changed from 4.37 percent to 5.06 percent. In Nevada, total loans past due changed from 2.8 percent to 4.41 percent. While Nevada's total delinquencies are below the national average, they have been rising rapidly, he said. For the United States, new foreclosure starts rose from 0.4 percent to 0.59 percent. In Nevada, new foreclosure starts increased from 0.3 percent to 0.89 percent, a tripling. Mr. Duncan said the rate of change in Nevada is high, and that Nevada is one of the states driving the national changes. For the United States, the foreclosure inventory increased from 0.99 percent to 1.4 percent. In Nevada, the foreclosure inventory increased from 0.45 percent (half the national average) to 1.57, surpassing the national average. Although total delinquencies in Nevada were below the national average, Nevada foreclosures moved ahead of the national average. Please see **Exhibit B**.

  Mr. Duncan's presentation compared national changes in employment, population growth, and house prices with the changes that have occurred in Nevada. He stated that Nevada's employment growth is above the national average, and employment is not currently an issue where housing is concerned. However, employment figures in Nevada could decline as housing construction declines. Nevada's population has grown, where other states show a loss in jobs and population. Arizona, California, Florida, and Nevada have common characteristics. In these states, population and employment growth has been strong; however, housing permits in Nevada have declined since the market peaked in 2005.

Continuing, he explained that housing construction normally increases in proportion to population growth, but regional economic factors including employment and housing prices affect this relationship. In the four-state group there was a dramatic increase in housing production relative to the pace of population increase, which probably indicates overbuilding. Consequently, the large supply of houses on the market will have to be worked off while housing prices are declining. He presented information on the supply of houses in the Reno and Las Vegas areas that need to be worked off before stability in the housing market can return.

Mr. Duncan said that Nevada had experienced speculative over-building related to a rapid run-up in housing prices and was now seeing the reverse of that. Prices have declined greatly in Nevada, and his organization expects them to decline further, whereas in 35 other states, housing prices are still rising. He said that the percentage of sales to owners who do not occupy the homes was very high in some markets, including Las Vegas; that Nevada had a high percentage of subprime loans in 2006 compared to the rest of the nation; that Nevada has a significant portion of nonconforming loans, although not as numerous as in California, Florida, and the District of Columbia; and that Nevada, along with Arizona, California, and Florida, led the nation in new foreclosure starts in the second quarter of 2007.

Mr. Duncan said that, from discussions with the Federal Reserve, many nominally owner-occupied homes are actually not owner-occupied and have subprime loans, which are not usually the realm of investors. He said 32 percent of loans in foreclosure in Nevada were investor properties. In Nevada, the underlying economy is sound, but speculative activity is adversely affecting even persons who had intended to live in their homes, because their prices are declining, many of their loans are adjustable, and their homes may be worth less than they owe.

Continuing, Mr. Duncan said there is still a large amount of equity in homes, but it is distributed unevenly between recent buyers and past buyers. Some persons who are now having problems making their payments may have done more than one cash-out refinance, which has public policy implications.

In conclusion, Mr. Duncan said the MBA expects housing prices to reach the bottom at the end of the third quarter of 2008. A large supply must be worked off, and there are constraints on demand related to changes in capital markets. He said housing prices will decline for two consecutive years in 2007 and 2008, for the first time since World War II, and the risks are further on the down side, depending on the national economy.

In response to a question from Chairman Conklin, Mr. Duncan explained the difference between nonconforming and subprime loans. He said that nationally in 2006 approximately 80 percent of subprime loans were securitized by investors, which means the loans became collateral for an asset-backed security in the market. Based on the MBA's database, there are approximately 108,000 subprime loans in Nevada, or 19.6 percent, the highest in the nation.

- In response to questions from Senator Hardy, Mr. Duncan provided information on the methodology for estimating the number of investor-owned mortgages and said an update could be provided to the Subcommittee. Senator Hardy said that the prediction that the mortgage-lending problems would end in the third quarter in 2008 did not apply to Clark County but to loans nationwide. Mr. Duncan agreed but said that a reduction in the housing inventory in Nevada may be constrained by stricter credit terms, falling prices in California, and slowing employment growth.

- Assemblyman Grady asked why the MBA was not aware of the investor-owned component of mortgage problems and was of the opinion that greed played a role in the current housing market issues. Mr. Duncan said that electronic mortgage processing has been a factor. He stated that mortgage financing has broadened tremendously with the increased use of computers and the Internet, which reduces the interface between borrowers and lenders.

- Senator Schneider commented that Wall Street investors and corporate builders have significant influence on the mortgage-lending industry. He was of the opinion that these entities assume no responsibility to the communities that have been negatively affected. He said that corporate builders came to Nevada, drove the local homebuilders out of business, and created the problems occurring in the housing industry. He said mortgage brokers pushed loans with higher commissions and gave people loans as fast as possible to increase profitability. The loans were then bought in the secondary market. He stated that loans are being offered on the Internet now; therefore, the market is still not under control. He was of the opinion that Wall Street investors bear the responsibility for enticing mortgage brokers to make riskier subprime loans.

- Mr. Duncan said from an economic viewpoint two important categories for consideration of public policy are: (1) asymmetry of information; and (2) contingent liability. He stated that there is an asymmetry of information between the borrower and the lender. The borrower lacks information about the cost of funds, operational capabilities, cost efficiencies, and loan products, and the lender cannot be assured that the borrower will not overload with debt. Regarding contingent liability, he said if all parties are aligned economically, the transaction has a greater likelihood of success. The public policy question is whether the investor, broker, and realtor are committed to the success of the loan. Over 100 companies that originated loans have gone out of business, and issuers and investors have had significant losses as well. He was of the opinion that the disclosure of information to all parties of the transaction would assist in fixing the problem.

  In response to questions from Assemblywoman Kirkpatrick, Mr. Duncan said Nevada is below the national average in loans past due, but well above the national average in foreclosure starts and foreclosure inventory. He said this may be due to the fact that some loans are moving rapidly into foreclosure and not going through the normal delinquency process, either because they were fraudulent (i.e., no payment was ever made) or they were investor properties. He said the MBA anticipates

Arizona, California, Florida, and Nevada will continue to see increases relative to the national averages.

- In response to a question from Chairman Conklin regarding housing prices and affordability, Mr. Duncan said one needs to examine a combination of relationships to determine the optimal range for housing prices: (1) house prices and replacement costs; (2) house prices and household income; and (3) monthly mortgage payments and rental payments.

- Chairman Conklin asked whether the number of non-owner occupied homes may be understated due to unreported information, particularly in the subprime category. Mr. Duncan stated that 2006 data is available and can be provided to the Subcommittee. He added a significant number of investor properties may have been cash purchases.

- Jeremy Aguero, Principal, Applied Analysis, Las Vegas, presented information prepared, in part, for the Southern Nevada Homebuilders Association on residential delinquencies, foreclosure starts, foreclosure inventory, unsold inventory; home sales and prices; government revenue; consumer spending; construction; and economic development.

  Mr. Aguero displayed a series of slides covering: loans past due; seriously delinquent loans; foreclosure inventory and starts; subprime loans and adjustable rate mortgages as a percentage of total loans; foreclosure locations and ownership; new home sales and prices; existing home sales and prices; taxable retail sales; taxable property values; residential units permitted; commercial permits issued and value permitted; construction employment; employment growth; and economic development. Please see **Exhibit C**.

  During his testimony and in response to questions from Subcommittee members, Mr. Aguero indicated that:

  - A large number of housing units were sold in Nevada in a relatively brief period of time, which is one reason for the differences between Nevada and national average delinquency and foreclosure data;

  - In southern Nevada, there have been about 44 foreclosures each day for the last four months;

  - Foreclosures are not localized in any particular area of Clark County, although many are in the emerging communities;

  - To determine ownership of foreclosed properties, Applied Analysis compared available foreclosure records for January to September 2007 with the assessor's address for the property tax bill, and assumed that the owner did not occupy the property if the tax bill was not sent to the property;

- Using this method, Applied Analysis estimates in-state, non-owner-occupied units represent about 11 percent of foreclosures, and out-of-state, non-owner-occupied units represent about 49 percent of foreclosures;

- California is a large consumer of real estate products in Nevada;

- Declining home prices are of concern and are acting in concert with increasing foreclosures;

- Recent trends in taxable retail sales, which tend to be cyclical, are of concern;

- Although there has been continued growth in commercial permit valuation in Clark County, there has been a drop-off in commercial permits issued;

- Construction employment in southern Nevada is near the national average, and although there has been a drop-off related to the decline in the residential sector, some employees have been able to transition to the commercial sector, in which $36 billion in hospitality investment is currently under construction with an additional $15 to $20 billion not yet underway;

- Southern Nevada is concerned about attracting enough employees to staff the greater-than-$36 billion investment in hospitality properties; and

- Although Nevada is not immune from national economic cycles, there may be a workforce housing shortage by the end of 2009 or in 2010, and one should not assume Nevada's latest economic boom will be its last one.

Mr. Aguero said that the taxable value of single-family residential development in Clark County is $148 billion for the 2007-2008 tax year. A 1 percent decline in value results in greater than a $1 billion impact on single-family residential homeowners. An average single-family household sees a decline of $3,225 in household wealth for every one percent decline in value. In answer to a question from Chairman Conklin, Mr. Aguero said that in much the same way as an increase in equity created a boom in spending, Nevada is now seeing somewhat of an opposite effect. In 2005, with the passage of Assembly Bill 489 (Chapter 20, *Statutes of Nevada*), governments are somewhat insulated from declines in property values, but that is not true for individual consumers, he said.

- R. Keith Schwer, Ph.D., Director, Center for Business and Economic Research, University of Nevada, Las Vegas, discussed some of the reasons for the current problems in the mortgage lending and housing sectors, citing financial innovation and deregulation, a world savings glut, and other factors. He presented a series of slides covering:

  - Housing prices in Nevada, southern Nevada, and other states and metropolitan areas;

- Availability and sales of single-family homes and condominiums in the greater Las Vegas area;

- Residential permits issued in Clark County;

- Las Vegas apartment rental rates and vacancies;

- Job growth, civilian unemployment, and in-migration in southern Nevada and other areas;

- United States and Nevada real weekly wages;

- Business conditions in southern Nevada and the United States; and

- Results of a questionnaire circulated in southern Nevada regarding numbers of houses owned, percent of monthly budget spent on housing, and duration of home ownership.

During testimony and in response to questions from Subcommittee members, Dr. Schwer indicated that:

- Compared to the Los Angeles, Phoenix, and San Diego metropolitan areas, the Las Vegas region ranked highest in recent housing price appreciation, displaying clear speculative behavior and permitting of too many new housing units;

- Housing prices in the Las Vegas region were near the national average for many years, which is one reason for the region's population growth, and prices increased significantly in 2004 and 2005 and became more like prices in other major western metropolitan areas;

- There has been a significant drop in housing affordability in southern Nevada in the last few years, about one in every three persons faces a housing cost burden over 40 percent of his monthly budget; and weekly wage earners earn less than the national average;

- Southern Nevada has seen a slowdown in in-migration, needs to work off an inventory of over 27,000 vacant housing units, and—if home prices are a major factor in business decisions—new employers and employees may decide to stay where they are;

- The United States and Nevada experienced very good economic times in the 1980s and 1990s, and when international and national economies are strong, southern Nevada benefits because it sells its services in those economies; and

- The economic impact of foreclosures is difficult to measure without looking in detail at the models employed; in trying to estimate the impacts, one should consider the cost to government and the cost of blight (i.e., the declining value of assets); and there are some indications that large numbers of foreclosures do blight neighborhoods, especially if homes are vacant. Please see **Exhibit D**.

- Kenneth J. LoBene, Field Office Director, Las Vegas Field Office, United States Department of Housing and Urban Development, was not available to testify.

REVIEW OF ROLE OF TAXABLE AND TAX-FREE BONDS IN MORTGAGE LENDING MARKETS

- Mendy K. Elliott, Director, Department of Business and Industry (DBI), discussed whether the State could create a bond fund for gap financing covering the secured and unsecured debt of borrowers. She was of the opinion that it would not be prudent. In response to a question from Assemblyman Grady, Ms. Elliott explained that such a fund would be directed at the subprime market. Chairman Conklin stated that not all loans in foreclosure are subprime loans. Ms. Elliott explained that if a loan was unsecured, there would be no recourse for a default on the loan. She said that a credit enhancement is issued based on the collateral that it supports, and in this case there is none because it is an unsecured loan. Please see **Exhibit E**.

  In response to a question from Chairman Conklin, Ms. Elliott discussed Nevada's first-time homeowner assistance program and the sale of secured loans in the secondary market by the DBI. She said this program has been very successful, all loans are fixed-rate loans, and that loans are now in high demand.

PUBLIC COMMENT

- Former Senator Joe Neal, Las Vegas, was of the opinion that the mortgage banking industry played an important role in creating the current mortgage problems. He did not support the creation of a State bond fund. He recommended that the Subcommittee urge the U.S. Congress to freeze current subprime loan rates and asked the Subcommittee to focus on the people of Nevada who are negatively affected by the current problems in the mortgage lending industry.

SCHEDULING OF FUTURE MEETINGS

- Chairman Conklin asked the members to send him information on their availability for scheduling the next meeting.

ADJOURNMENT

There being no further business to come before the Subcommittee, the meeting was adjourned at 12:10 p.m.

Respectfully submitted,

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Lucinda Benjamin
Senior Research Secretary

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David Ziegler
Principal Research Analyst

APPROVED BY:

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Assemblyman Marcus L. Conklin, Chairman

Date: ________________________________

LIST OF EXHIBITS

Exhibit A is the "Meeting Notice and Agenda" provided by David Ziegler, Principal Research Analyst, Research Division, Legislative Counsel Bureau.

Exhibit B is a Microsoft PowerPoint presentation titled "Mortgage Lending Problems and Impacts in Nevada," presented by Douglas G. Duncan, Ph.D., Chief Economist, Mortgage Bankers Association, Washington, D.C.

Exhibit C is a Microsoft PowerPoint presentation titled "Nevada Housing Market Conditions" presented by Jeremy Aguero, Principal, Applied Analysis.

Exhibit D is a Microsoft PowerPoint presentation titled "Housing Impact Issues in Nevada," presented by R. Keith Schwer, Ph.D., Director, Center for Business and Economic Research, University of Nevada, Las Vegas.

Exhibit E is a document titled "Housing Reality," which was submitted by Mendy K. Elliott, Director, Department of Business and Industry.

This set of "Summary Minutes and Action Report" is supplied as an informational service. Exhibits in electronic format may not be complete. Copies of the complete exhibits, other materials distributed at the meeting, and the audio record are on file in the Research Library of the Legislative Counsel Bureau, Carson City, Nevada. You may contact the Library online at www.leg.state.nv.us/lcb/research/library/feedbackmail.cfm or telephone: 775/684-6827.